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## Finally a Final RESPA Rule

After five months and 12,000 public comments on the proposed rule to reform the Real Estate Settlement Procedures Act (“RESPA”), the U.S. Department of Housing and Urban Development (“HUD” or “Department”) published its final RESPA rule on Monday, November 17, 2008. While the lion’s share of comments from trade associations, settlement service providers, and even some consumers and federal agencies were negative, ultimately HUD held firm to the core principles it espoused in the proposed rule. For example, the Good Faith Estimate (“GFE”), reduced from four pages to three, still contains those pesky tolerances. And, the HUD-1 Settlement Statement (“HUD-1”), though minimally modified, now includes a third page to accommodate an explanation of the loan terms that HUD holds so dear. It is clear that the Department believes its forms will assure a more transparent settlement transaction. Accordingly, this client alert summarizes the most significant provisions of the final rule, compares those provisions to HUD’s proposals, and provides our initial observations as to how the settlement service industries are likely to view the new RESPA rule.

### I. Good Faith Estimate

The GFE is the signature piece of the final RESPA rule. HUD did not budge from the proposed look of the form, the use of certain charts to give comparative information to consumers, and the imposition of tolerances regarding the change in settlement charges at closing. But, in response to public comments, the Department did shorten the form and alter certain language. We describe the final GFE document in more detail below.

#### A. Standardized GFE Form

Although HUD shortened a four-page standardized GFE form to a three-page form, little of the proposed content was removed in the final rule. Effective January 1, 2010, HUD will require mortgage lenders and mortgage brokers to provide consumers with the standard GFE form within three days of receiving an “application.”<sup>1</sup> Attached to this client alert is a copy of the final GFE. Like the proposed form, the final GFE form includes a summary of the key terms of the loan, as well as an estimate of total settlement charges, which HUD expanded and reorganized in certain instances.<sup>2</sup>

(i) The key loan terms include the following:

- the initial loan amount;
- the loan term;
- the initial interest rate;
- the initial monthly mortgage amount owed for principal, interest and any mortgage insurance;
- whether the interest rate, the loan balance and the monthly payment may rise;
- whether the loan has a prepayment penalty and balloon payment.

For the final GFE form, HUD created a new section for the summary of monthly escrow obligations. These items, along with important dates and instructional statements, appear on page one of the form.

(ii) The final GFE also provides for the estimate of **total settlement costs** in the following 11 categories:

- the origination charge, which will include any lender processing and underwriting fees;
- a credit or charge (points) for the interest rate chosen;
- required services selected by the lender, such as appraisal and flood certification fees;
- title service fees and the cost of lender's title insurance;
- owner's title insurance;
- other required services for which the consumer may shop;
- government recording fees;
- transfer tax charges;
- initial deposit for escrow;
- daily interest charges; and
- the cost of homeowner's insurance.<sup>3</sup>

These settlement charges are disclosed on page two of the GFE. Note that HUD created separate categories for government recording fees and transfer taxes and reshuffled the order of these settlement costs on page two. Much to the relief of the title industry, the Department also removed the word "optional" from owner's title insurance.

Like HUD's proposed GFE, the final rule requires a mortgage lender or broker to keep the GFE's stated settlement costs open for 10 business days to allow the consumer to comparison shop with other loan originators.<sup>4</sup> With regard to the initial interest rate, the GFE must identify that the rate is available until a specified date. Until that rate is locked, however, the initial interest rate may continue to float.

Page three of the final GFE form provides space for a lender or broker to present a borrower with two additional loan options in a chart format – one with a higher interest rate and one with a lower interest rate. The purpose of the comparison is to demonstrate how a higher interest rate could reduce up-front settlement costs and a lower interest rate could increase the

charges a consumer would pay at the closing table. However, unlike the proposed rule, HUD now makes completion of the chart optional for the lender, which is explicitly stated on the face of the GFE.<sup>5</sup>

Finally, because HUD's goal from the beginning was to create a GFE form that allows consumers to shop for a mortgage loan, the Department salvaged a blank chart from page four of the proposed form that would allow consumers to write in the loan terms of four lenders' offers of credit.<sup>6</sup> This "shopping chart" now appears at the bottom of page three. This means, therefore, that HUD eliminated the remaining items from page four that were not otherwise incorporated into the final GFE, including estimates for property taxes and homeowner's insurance.

### B. Tolerances

Related to the estimate of settlement charges on the GFE, HUD did not alter its proposal to create three separate categories of settlement charges and subject them, absent "changed circumstances,"<sup>7</sup> to different tolerances.<sup>8</sup> The first category of fees is subject to a zero tolerance standard, meaning the fees estimated on the GFE may not be exceeded at closing.

- **Zero tolerance** fees would include: (1) the lender or broker's own origination charge (i.e., processing and underwriting fees); (2) the credit or charge to the borrower for the interest rate chosen (i.e., yield spread premium or discount points); and (3) transfer tax charges. Note that HUD listened to both the concerns of the mortgage and title insurance industry that government recording fees cannot be precisely determined at the GFE stage. As a result, HUD removed government recording fees from the zero tolerance category into the 10% tolerance category below.

HUD will subject the sum of the fees in the second category to a 10% tolerance. While each individual fee may increase or decrease, the sum of the total increases may not exceed 10% at closing.

- **10% tolerance** fees include: (1) lender-required settlement services where the lender selects the third party provider (i.e., appraisal fees and tax search fees); (2) lender-required services where the borrower selects a third party provider recommended by the lender (i.e., title and closing services and lender's title insurance); (3) owner's title insurance when the borrower uses a provider identified by the lender; and (4) government recording charges.

The final category of fees is subject to no restriction under the final rule, meaning the Department will not limit the amount of any increase in the fees that may appear on the HUD-1. These fees, therefore, may increase by more than 10% at closing.

- **No restriction** fees include: (1) lender-required services where the borrower shops and selects his or her own third party provider (i.e., title and closing services and lender's title insurance); (2) owner's title insurance where the borrower selects a third party provider; (3) initial escrow deposits; (4) daily interest charges; and (5) the cost of homeowner's insurance.

### C. Disclosure of Yield Spread Premiums/ Backend Fees

In what appears to be a defeat for the mortgage brokers, HUD did not alter its proposed disclosure of yield spread premiums as a "credit or charge (points) for the specific interest rate chosen."<sup>9</sup> Despite numerous comments from settlement service industries that consumers will not understand that a "credit" signifies that a mortgage broker is being compensated in the transaction, HUD will require that a "credit" field be used to disclose the presence of a yield spread premium and a "charge" field be used to denote the presence of discount points on the GFE.

To accomplish this, the rule requires a mortgage originator to disclose all internal origination fees on page two of the GFE as "our origination charge." If a mortgage lender will pay a broker a fee, like a yield spread premium, on the loan, the mortgage broker is required to disclose the premium as "a credit of \$ \_\_\_\_\_ for this interest rate of \_\_\_%" and subtract it from "our origination charge" to arrive at the "adjusted origination charge."<sup>10</sup> Conversely, if a borrower elects to pay discount points to reduce the interest rate on the loan, the amount of the discount points should be added to the "our origination charge" to arrive at the "adjusted origination charge." Just like the proposed rule, this disclosure covers any charge a lender pays a broker, and nowhere on the new GFE form does HUD label the disclosure with the terms "yield spread premium." How HUD thinks this will simplify or clarify the process for consumers remains a mystery.

### D. GFE Fees

In the proposed rule, HUD stated its preference that mortgage lenders and mortgage brokers not impose any charges for a GFE. The Department, however, followed the lead of the Federal Reserve Board and

its restrictions on fees related to the Truth in Lending disclosure. The final rule, therefore, limits the fee a mortgage originator may charge for the GFE to the cost of a credit report.<sup>11</sup> A lender or broker is not permitted to charge, as a condition of providing a GFE, any fee for an appraisal, inspection, or similar settlement service. Again, where HUD gets the authority to dictate lender fees in this instance is unclear from a plain reading of the statute.

### E. FHA Origination Fees

Finally, under current FHA regulations, the Department limits the amount of an origination fee a mortgagee may collect on an FHA-insured loan to 1% of the loan amount. As the Department believes more competition in the marketplace will drive down lenders' origination fees, HUD has removed this limitation with the final RESPA rule. Effective January 1, 2010, FHA-approved mortgagees may collect any fee to compensate it for expenses incurred in originating and closing the loan. The FHA Commission, however, is still free to establish limitations on the amount of any such origination fee.<sup>12</sup>

## II. HUD-1 Settlement Statement

Unlike the Department's modifications to the GFE, HUD does not change the format of the current HUD-1; in fact, the first page of the HUD-1 is nearly identical to the document currently in use. However, HUD does generally adopt its proposed form, which alters page two of the HUD-1 to allow consumers to directly compare the fees identified on the GFE to those fees charged at closing.<sup>13</sup> The final HUD-1 also identifies the settlement charges using the same terms as the GFE (i.e., "our origination charge" for lender fees and "owner's title insurance"), and the Department includes parenthetical text next to most itemized fees that identifies the section of the GFE where a consumer will find the estimated charge.<sup>14</sup> For instance, the appraisal fee and credit report fee will be estimated in Item 3 of the GFE form. To allow a consumer to compare these fees with those reflected on the HUD-1, the new HUD-1 will include "(from GFE #3)" next to the itemized entry for the appraisal and credit report in the 800 series of the HUD-1. These modifications appear to be a direct result of public comments that criticized the proposed HUD-1's lack of synchronization with the GFE. Attached to this client alert is a copy of the final HUD-1.

In addition, while the current HUD-1 requires a lender or mortgage broker to itemize their internal origination charges, such as processing fees and document preparation fees, the new HUD-1 form will require only the lender's bundled "origination charge" to be disclosed at closing.<sup>15</sup> Similarly, rather than itemize fees for certain title services, such as the title search, title examination, and title binder, to name a few, the final HUD-1 provides for a single "title services and lender's title insurance" fee to be disclosed in Line 1101 of the document.<sup>16</sup> This category of fee matches that on the final GFE form. The Department, however, has maintained a separate line item for the settlement or closing fee, which is a change from the proposed rule.

Despite the single fee for "title services and lender's title insurance," HUD appears to have heard the comments of the title industry, which argued that the disclosure of a bundled fee for title services could hinder a consumer's ability to know what he or she is paying for and shop for the best price. In the instructions to the final HUD-1, the Department states, "The title charges include a variety of services performed by title companies or others, and include fees directly related to the transfer of title, . . . [but] [d]isbursements to third parties must be broken out in the appropriate lines or in blank lines in the [1100] series, and amounts paid to these third parties must be shown outside of the columns if included in Line 1101 (title services and lender's title insurance)."<sup>17</sup> Thus, while Line 1101 will disclose a bundled fee, it appears that HUD will still require fees paid to third parties in connection with the issuance of a title policy to be separately itemized. For instance, in those cases where the title insurance company engages a third party to perform the title search, the name of the title search vendor should be separately itemized in the 1100 series of the new HUD-1.

The final HUD-1 also retains the proposed disclosure of the title agent's portion and title underwriter's portion of the total title insurance premium. In Lines 1107 and 1108 of the final form, the dollar amount of the premium paid to both the title agent and title underwriter must be separately disclosed, despite comments from the title industry against this disclosure.<sup>18</sup> In addressing these comments, HUD merely states that "it is HUD's view that this breakdown will help consumers better understand their title charges."<sup>19</sup> This may or may not be true, but one thing is certain – this change will give title underwriters heartburn.

### III. Closing Script

In the proposed rule, HUD planned to create a new addendum to the HUD-1, or a closing script, and task the settlement agent with preparing it, reading it aloud to the consumer at closing, and providing it in hard-copy format to obtain the consumer's written acknowledgment. In the final rule, while HUD agrees to abandon the idea of the closing script, the Department still felt compelled to get the closing script information to consumers. HUD, therefore, developed a new page three to the HUD-1 that crams a scaled-down version of the information proposed for the closing script into a single page.<sup>20</sup> Notably, the top half of page three includes a chart for the comparison of the GFE fees and the final charges on the HUD-1. This chart is identical to the one included in the proposed closing script. In addition, the second half of page three includes a summary list of the loan terms.<sup>21</sup> The format for this list is nearly identical to the summary of loan terms appearing on page one of the GFE.

In response to the proposed closing script, the title and settlement industries raised a number of concerns and issues with HUD's plan to require the settlement agent to read aloud and explain settlement charges and loan terms to the borrower, including a concern that an explanation of the loan terms could subject settlement agents to unauthorized practice of law concerns. Again, HUD appears to have listened to these concerns. Although settlement agents still will be tasked with preparing the new page three to the HUD-1, the Department includes a specific mandate for lenders to provide the settlement agent with sufficient information to complete page three. With regard to the GFE and final settlement charges, Section 3500.8 of RESPA's regulation has been revised to state that "the loan originator must transmit to the settlement agent all information necessary to complete the HUD-1."<sup>22</sup> Moreover, the newly revised instructions to the HUD-1 provide that the loan terms section must be completed in accordance with the information and instructions provided by the lender. "The lender must provide this information in a format that permits the settlement agent to simply enter the necessary information in the appropriate spaces, without the settlement agent having to refer to the loan documents themselves."<sup>23</sup> Arguably, therefore, as long as mortgage lenders provide settlement agents with copies of the GFE or otherwise complete the summary of loan terms, the

settlement agent should have enough information to complete the new page three. Moreover, in response to the public comments of the title and settlement industries, if the consumer has questions about the information disclosed on page three, HUD added a statement to the form, which directs the consumer to contact the lender.<sup>24</sup>

#### IV. Average Charges and Negotiated Discounts

Although the revised GFE and HUD-1 are HUD's primary components to the final rule, HUD also proposed to allow lenders and mortgage brokers to use average cost pricing for settlement services, rather than charge the consumer the exact cost in every circumstance.<sup>25</sup> Initially, HUD would have allowed a lender to determine the average cost by using the actual average cost of a settlement service over the previous six-month period or a tiered pricing approach. In the final rule, HUD revises this proposal and uses the term "average charge" in place of "average cost pricing."<sup>26</sup> Most importantly, the use of an average charge is no longer restricted to loan originators; HUD clarifies in the final rule that any settlement service provider that is able to calculate an average charge for a service is permitted to use an average charge for that service.<sup>27</sup> Note, however, that if a lender uses average charges, it still will be held accountable for those charges by the tolerance limitations.

HUD also retreats from its plan to prescribe a particular method for calculating average costs. The final rule provides that "an average charge may be used for any settlement service, provided that the total amounts received from borrowers for that service for a particular class of transactions<sup>28</sup> do not exceed the total amounts paid to the providers of that service for that class of transactions."<sup>29</sup> This leaves the method of determining the average charge up to the discretion of the settlement service provider. The provider must recalculate the average charge at least every six months, and if an average charge is used in any class of transactions defined by the provider, then it must be used for every transaction within that class.<sup>30</sup> Note, however, that the final rule prohibits the use of average charge for settlement services where the charge is based on the loan amount or the value of the property (*i.e.*, title insurance, daily interest charges). The average charge also appears to be permitted only for third party vendor charges and not a settlement service provider's own internal charges.

Finally, HUD proposed to amend the definition of "thing of value" to exclude discounts negotiated by settlement service providers in the price of a third party settlement service, as long as no more than the discounted price is charged to the borrower and disclosed on the HUD-1. The Department, however, acquiesced to the concerns of the real estate broker and title industries and declines to incorporate such a change into the final rule. In response to numerous comments suggesting negotiated discounts could have a substantial adverse impact on small businesses' ability to offer discounts and compete with larger providers, HUD does not finalize the proposed amendment to the definition of "thing of value." Instead, HUD states that it "has decided to give further consideration beyond this rulemaking to a regulatory change that explicitly allows negotiated discounts, including volume based discounts, between loan originators and other settlement service providers."<sup>31</sup> That being said, HUD makes its intentions clear and emphasizes that "discounts negotiated between loan originators and other settlement service providers, or by an individual settlement service provider on behalf of a borrower, where the discount is ultimately passed on to the borrower in full, is not, depending upon the specific circumstances of a particular transaction, a violation of Section 8 of RESPA."<sup>32</sup>

#### V. Required Use

HUD's proposed rule planned to modify the current definition of "required use" to make four primary changes. First, the definition would include both economic incentives and disincentives that are contingent on a borrower's use or failure to use a particular provider of settlement services. Second, the proposed rule would have allowed only borrowers to receive discounts under the revised definition. Third, with regard to affiliated business arrangements, HUD's proposal would have prohibited a provider from offering a discount or incentive to a consumer and linking the discount to the consumer's use of affiliate companies. The provider's affiliate companies, however, would be allowed to offer their own discounts. For example, a parent real estate broker that wholly owns both a mortgage banker affiliate and a title agency affiliate could not tie its incentives to use of its affiliated mortgage and title companies. HUD's concern was that such a practice would lead the real estate broker

in this example to steer consumers to its own affiliates (when the affiliates may not offer the best prices) or to raise prices to cover the real estate broker's incentives. The affiliated mortgage company and title agency, however, could offer the consumer direct discounts on their mortgage products and title services. Finally, HUD proposed to limit this ability to offer discounts to "settlement service providers," which excluded homebuilders.

HUD largely finalized these four proposals regarding required use with some modifications in the language used to define the term, as well as the way discounts can be tied to affiliated business arrangements. In addition to making "it clear that economic disincentives that are used to improperly influence a consumer's choices are problematic under RESPA,"<sup>33</sup> effective January 16, 2009, the definition of "required use" is as follows:

Required use means a situation in which a person's access to some distinct service, property, discount, rebate, or other economic incentive, or the person's ability to avoid an economic disincentive or penalty, is contingent upon the person using or failing to use a referred provider of settlement services. In order to qualify for the affiliated business exemption under §3500.15, a settlement service provider may offer a combination of bona fide settlement services at a total price (net of the value of the associated discount, rebate, or other economic incentive) lower than the sum of the market prices of the individual settlement services and will not be found to have required the use of the settlement service providers as long as: (1) the use of any such combination is optional to the purchaser; and (2) the lower price for the combination is not made up by higher costs elsewhere in the settlement process.<sup>34</sup>

Under the final rule, HUD expanded the language of the definition to apply to a "person," instead of a "borrower," in response to a number of public comments. Accordingly, both buyers and sellers are eligible to receive discounts under the final definition. Moreover, with regard to affiliated business arrangements, HUD modified the rule to allow the owners of affiliated companies (*i.e.*, the parent real estate broker in the example above) to offer discounts and incentives to consumers and link those discounts to the consumers' use of affiliate companies (*i.e.*, the wholly-owned mortgage and title companies in the example above). In other words, the parent real

estate broker could offer the buyer a cash incentive if the consumer chooses to obtain a mortgage from the broker's affiliate lender. However, the final rule still limits these discounts to "settlement service providers." Despite public comments highlighting the exclusionary effect of this language on homebuilders and their ability to offer consumer incentives, HUD is adamant in restricting the ability of builders to offer discounts and other incentives to encourage the use of their affiliate companies.<sup>35</sup> Although HUD's core value for the required use change is to promote competition and lower consumer prices, it is difficult to understand how precluding only builders from offering these customer incentives satisfies HUD's goal.

## VI. Effective Dates

Although the final rule generally gives lenders and settlement agents one year to adapt to the use of the new GFE and HUD-1 forms, the final rule provides for varying effective dates. Notably, the following components of the final rule become effective **January 16, 2009**: (1) the revised definition of required use; (2) the use of average charges; and (3) the rule's miscellaneous modifications regarding escrow accounts, servicing transfer notifications and the applicability of ESIGN.<sup>36</sup>

The remaining following components of the final rule become effective **January 1, 2010**: (1) use of the new GFE, including disclosure of yield spread premiums and the tolerance restrictions; (2) use of the new HUD-1; and (3) all revised definitions (except required use) in Section 3500.2 of RESPA's regulation.<sup>37</sup> While a lender or settlement agent may use the new forms prior to the 2010 effective date, such use will subject the lender or settlement agent to all new requirements under the final rule (*i.e.*, tolerance restrictions).

## VII. Industry Reaction

Although the above discussion is a mere summary of the changes HUD made to the GFE and HUD-1 disclosures, the use of average charges and the definition of required use in the final rule, these changes are getting heated reactions from the settlement service industries affected by this rule. And, as with any regulatory actions, there are both perceived winners and losers.

### A. Mortgage Industry

With regard to the lending industry, although HUD did loosen some of its proposed standards on loan originators, the Department generally was unwilling to compromise on many aspects of the rule affecting lenders. First, it is no secret that the mortgage industry strongly pushed for a collaborative effort between HUD and the Federal Reserve Board to produce consistent and uniform disclosures. Yet, HUD did not wait on or initiate this collaboration. Instead, the Department expressed its belief that GFE and HUD-1 reform must happen now, particularly given the current state of the housing market. Second, other than moving government recording fees from the “zero tolerance” category to the “10% tolerance” category, the Department made no changes to its proposed tolerances. Under the final rule, mortgage lenders will be subject to certain tolerances on the settlement charges they estimate and disclose to consumers on the GFE. If the lenders exceed the applicable tolerances, the final rule deems the excess to be a violation of Section 5 of RESPA. Although neither Section 5 nor RESPA’s regulations provide consumers with a private right of action to pursue lenders for violations associated with the GFE, consumers still could bring claims for tolerance violations under state unfair and deceptive trade practice laws. However, in a break from the proposed rule, HUD will now give lenders a 30-day period following settlement to cure any excess tolerances. This should remove some of the pressure on mortgage originators to accurately estimate settlement charges at the GFE stage.

Third, although HUD did not remove the statement from the last page of the GFE regarding a lender’s possible sale of the loan in the secondary market, HUD did soften this language. This is in contrast to the Department’s decision to leave the disclosure of yield spread premiums as proposed, despite strong criticism from mortgage brokers, as well as other industry groups that argued consumers would not understand the “credit” to be an actual payment from the lender to a mortgage broker. Fourth, HUD abandoned its plan to impose a two-tiered application system, one which triggered the GFE and another which allowed the lender to proceed with a loan application. Under the final rule, lenders appear to have more discretion in collecting borrower information and deciding on

the appropriate time to give a consumer the GFE form. The lenders, however, will be allowed to collect only a credit report fee to cover their services in providing the GFE. As RESPA is not a rate-setting statute, there is still a legal argument that such a restriction is not appropriate. Finally, HUD modified its definition of “changed circumstances” to expand the situations under which a lender or broker is justified in giving consumers newly revised GFEs. Arguably, these modifications will aid mortgage lenders and brokers in complying with the final rule, including the tolerance requirements.

However, the costs to the lending industry of creating new software, new forms and training its staff will be staggering (at a time when the industry can least afford it). Understandably, lenders wanted HUD to coordinate these disclosures with future changes the Federal Reserve Board will make to the Truth in Lending disclosure, thereby requiring a single retooling rather than double duty. And, HUD’s insistence on holding lenders to a 10% tolerance on services they require or recommend means additional liability and potential lawsuits. So, while the mortgage bankers reaped some rewards in this final version of the rule, a strong measure of frustration and disappointment still remains.

### B. Title Insurance Industry

The title insurance and settlement industries received a number of concessions from the Department. Based on the public comments submitted by the American Land Title Association and other title insurance providers, the industry strongly opposed HUD’s proposed closing script, the allowance of negotiated discounts, which could create anti-competitive markets, the labeling of owner’s title insurance as “optional,” and the disclosure of the title agent’s and the title underwriter’s portions of the title premium on the HUD-1. HUD listened and ultimately declined to allow negotiated discounts as part of the final rule, and the Department removed the word “optional” from any reference to owner’s title insurance. HUD also abandoned its plan to create a new closing script, and even though certain “closing script” information is now included on page three of the HUD-1, the Department explicitly obligates mortgage lenders to supply settlement agents with sufficient information to complete page three without any reference to the borrower’s loan documents. It is

still possible that the new page three will extend the time required for closing, which could increase costs to consumers, but HUD made a concerted effort to address many of the title and settlement industries' concerns with the responsibilities imposed by the proposed closing script. In fact, page three of the HUD-1 now includes language directing the consumer to contact their lender (rather than the closing agent) with questions regarding final settlement charges and loan terms.

All that said, HUD declined to remove the disclosure of the title agent's and title underwriter's portions of the title premium from page two of the final HUD-1. The title industry had argued that such a disclosure was a matter of private contract and had no effect on the prices paid by consumers for title insurance. HUD responded to these comments by stating that the disclosure will help consumers better understand their title charges. Ultimately, the disclosure of the split in title premium will likely raise questions from consumers about the payment of premium to two parties, which should give the title industry the opportunity to educate consumers on the services performed by title insurance agents in connection with the issuance of title insurance policies. Moreover, given that other states already require the split in title premium to be disclosed to consumers (i.e., Massachusetts), this aspect of the final rule appears to be inevitable.

### C. Real Estate Brokers and Agents

The real estate industry shared many of the concerns of the title and mortgage industries and strongly encouraged HUD to collaborate with the Federal Reserve Board to produce consistent and easy-to-follow consumer disclosures. The National Association of Realtors® also raised objections to the Department's proposals for negotiated discounts out of concern that large settlement service providers would negotiate prices for bundled services and disadvantage small providers unable to compete with the discounted prices. Although HUD did not ultimately collaborate on a uniform disclosure with the Federal Reserve Board, the Department did attempt to rewrite certain language on the GFE to make it easier to understand. HUD also decided to forego negotiated discounts with this rulemaking. Thus, while no settlement service provider is likely to be satisfied with the final RESPA rule, the real estate brokerage industry may well see enough compromises in the final rule to live with its results.

### D. Homebuilders and Affiliated Business Arrangements

The biggest hit seems to have been taken by the homebuilders and their affiliated business arrangements. On the one hand, HUD modified its proposed definition of "required use" to ensure any person, not just borrowers, can take advantage of discounts and rebates. The Department also emphasized that any provider can offer to discount its own services. However, in order to qualify for the affiliated business exception to RESPA, the definition continues to refer only to "settlement service providers," which arguably excludes builders.

As you may recall, HUD proposed to alter the definition of required use in response to complaints that homebuilders were offering substantial discounts on the prices of their homes to those consumers that selected the builders' affiliate companies for mortgage and title insurance services. HUD suggested that such discounts effectively operated like economic disincentives that punished the consumer with a higher home price if he or she selected unaffiliated mortgage and title providers. The Department, therefore, amended the definition of "required use" to indicate that economic disincentives are problematic under RESPA. This language remains in the final rule's definition. But, HUD took it a step further. Despite judicial decisions holding that builder discounts tied to the use of affiliate companies are permitted under RESPA (as long as the discount is optional and is a true discount), the Department appears to see the economic disincentive claims strictly as a builder issue and, thus, has restricted the final rule accordingly.

As it relates to affiliated business arrangements, the final rule directs that "settlement service providers" may offer a combination of bona fide settlement services at a total price (net of the value of the associated discount, rebate, or other economic incentive) lower than the sum of the market prices of the individual settlement services. Since HUD takes the position that builders do not qualify as settlement service providers under RESPA, this provision effectively means that builders are not allowed to offer direct incentives to their customers tied to the use of affiliate companies. Yet, mortgage lenders, title companies, real estate brokers and any other entities that explicitly qualify as settlement service providers may offer direct discounts and incentives to their customers for the use of affiliate companies, as long as the total price for an affiliate's services is lower than the market price

of the services, the use of the affiliate is optional, and the lower price is not made up by higher costs in the settlement process. Without the ability to offer these same customer incentives, homebuilders believe the final rule will substantially disadvantage their efforts to operate successful affiliated businesses, as well as harm consumers that will not have access to discounted prices.

Moreover, given the January 16, 2009 effective date of the final “required use” definition, builders will have little time to make the necessary adjustments to their day-to-day business operations to comply with this rule. For instance, many homebuilders that offer discounts to consumers who elect to use their affiliate companies have pre-printed sales contracts governing these discounts. As of January 16, 2009, these contract provisions are invalid, which will leave builders scrambling to re-print contracts that comply with the final rule. Accordingly, if any provision of the final rule has the potential to cause continued controversy with the current Administration and the next, we expect the final “required use” definition to be it.

## VIII. Conclusion

Ultimately, HUD stuck to its proposed blueprint for RESPA reform. Sure HUD modified the floor plan a bit, and even changed the color of the drapes, but essentially the Department left its initial structure in place. The final GFE and HUD-1 forms are substantially the same as those proposed, and the Department made only minor modifications to its plans to allow average charges and further restrict the definition of required use. At the end of the day, after dispensing with a few goodies to the settlement service industries, HUD stuck to its vision of what consumers need to achieve transparency, clarity and increased shopping opportunities.

Where do we go from here? Don’t count on HUD extending the rule’s effective date beyond January 16, 2009 – their bags are packed and the moving vans are waiting. It remains to be seen whether the industry will have the stomach to file a lawsuit, and one would think the Obama Administration’s immediate priority at HUD will be keeping families in their homes, rather than scaling RESPA’s slippery slopes. So, this final rule will govern RESPA for now, but, it’s doubtful we’ve heard the last word on RESPA reform.

If you have any questions about the final RESPA rule or would like a more detailed explanation of its changes, please contact Phillip L. Schulman (202) 778-9027 / phil.schulman@klgates.com or Holly Spencer Bunting (202) 778-9853 / holly.bunting@klgates.com.

**Endnotes:**

- 1 “Application” is defined as “the submission of a borrower’s financial information in anticipation of a credit decision relating to a federally related mortgage loan, which shall include the borrower’s name, the borrower’s monthly income, the borrower’s social security number to obtain a credit report, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any other information deemed necessary by the loan originator.” 73 Fed. Reg. 68204, 68239 (Nov. 17, 2008). In the proposed rule, HUD would have required a mortgage originator to provide a GFE upon the receipt of a “GFE application.” Then, once a borrower decided to proceed with the loan, the loan originator could require the borrower to provide additional information through a “mortgage application.” HUD decided to pursue a single application process and allow the mortgage originator to decide how much borrower information is required before it issues a GFE. Id. at 68211.
- 2 See id. at 68208-68210, 68253-68258.
- 3 The GFE requires the lender or broker to total the estimated settlement charges and include them in a summary section prominently displayed on the first page of the GFE. See id. at 68253, 68256.
- 4 See id. at 68240.
- 5 73 Fed. Reg. at 68210, 68254, and 68258. Note that a lender or broker is required to complete the first column in the chart, which summarizes the terms of the loan presented in the GFE. The lender is not required to complete the remaining columns with alternative loan terms.
- 6 See id. at 68210.
- 7 “Changed circumstances” are defined as (1) (i) acts of God, war, disaster, or other type of emergency; (ii) information particular to the borrower or transaction that was relied on in providing the GFE and that changes or is found to be inaccurate after the GFE has been provided. This may include information about the credit quality of the borrower, the amount of the loan, the estimated value of the property, or any other information that was used in providing the GFE; (iii) new information particular to the borrower or transaction that was not relied on in providing the GFE; or (iv) other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance, or environmental problems. (2) Changed circumstances do not include: (i) the borrower’s name, the borrower’s monthly income, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any information contained in any credit report obtained by the loan originator prior to providing the GFE, unless the information changes or is found to be inaccurate after the GFE has been provided; or (ii) market price fluctuations by themselves. Id. at 68239. If any of these changed circumstances result in increased costs for any settlement service such that the costs at settlement would exceed the tolerances, the loan origination may provide a new GFE to the borrower. Similarly, if changed circumstances result in a change in the borrower’s eligibility for the loan terms identified in the GFE, the loan originator may provide a revised GFE to the borrower. The lender or broker must document these changed circumstances to be deemed in compliance with RESPA. Id. at 68241.
- 8 Id. at 68218-68219, 68240.
- 9 See id. at 68225.
- 10 See 73 Fed. Reg. at 68226.
- 11 See id. at 68213.
- 12 See id. at 68227.
- 13 See id. at 68249.
- 14 See id.
- 15 See 73 Fed. Reg. at 68228, 68249.
- 16 Id.
- 17 Id. at 68245.
- 18 See id. at 68245, 68249.
- 19 Id. at 68229.
- 20 See 73 Fed. Reg. at 68230.
- 21 See id. at 68250.
- 22 Id. at 68241.
- 23 73 Fed. Reg. at 68246.
- 24 See id. at 68250.
- 25 See id. at 68232, 68241.
- 26 If a settlement service provider uses the average charge for settlement services, the final rule maintains the recording keeping requirements. The provider must keep all documents that were used to calculate the average charge for at least three years after any settlement in which the average charge was used. See id. at 68242.
- 27 73 Fed. Reg. at 68234.
- 28 The final rule provides that a settlement service provider may define a class of transactions based on the period of time, type of loan, and geographic area. For example, a settlement service provider might calculate an average charge for all purchase money mortgages in the states of Georgia and South Carolina in a specified period of time. Id. at 68234. Alternatively, a settlement service provider could establish the class of transactions in which it would use a single average charge broadly (i.e., all transactions it engages in for a period of time, regardless of loan type or location). Id.
- 29 Id. at 68234.
- 30 Id.
- 31 Id. at 68232.
- 32 Id.
- 33 73 Fed. Reg. at 68236.
- 34 Id. at 68239-68240 (emphasis added).
- 35 In addition to the changes to the definition of “required use,” HUD finalized each of its proposals with regard to transfer of servicing requirements, escrow accounts, and the applicability of ESIGN. With regard to transfer of servicing, HUD made some revisions to the language on the model transfer of servicing disclosure to provide a more accurate description of the functions performed by loan servicers. HUD also eliminated the phase-in period for aggregate accounting for escrow accounts as proposed, and clarified the applicability of ESIGN to RESPA disclosures. Id. at 68237.
- 36 See id. at 68239.
- 37 Id.

K&L Gates' Mortgage Banking & Consumer Finance practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

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